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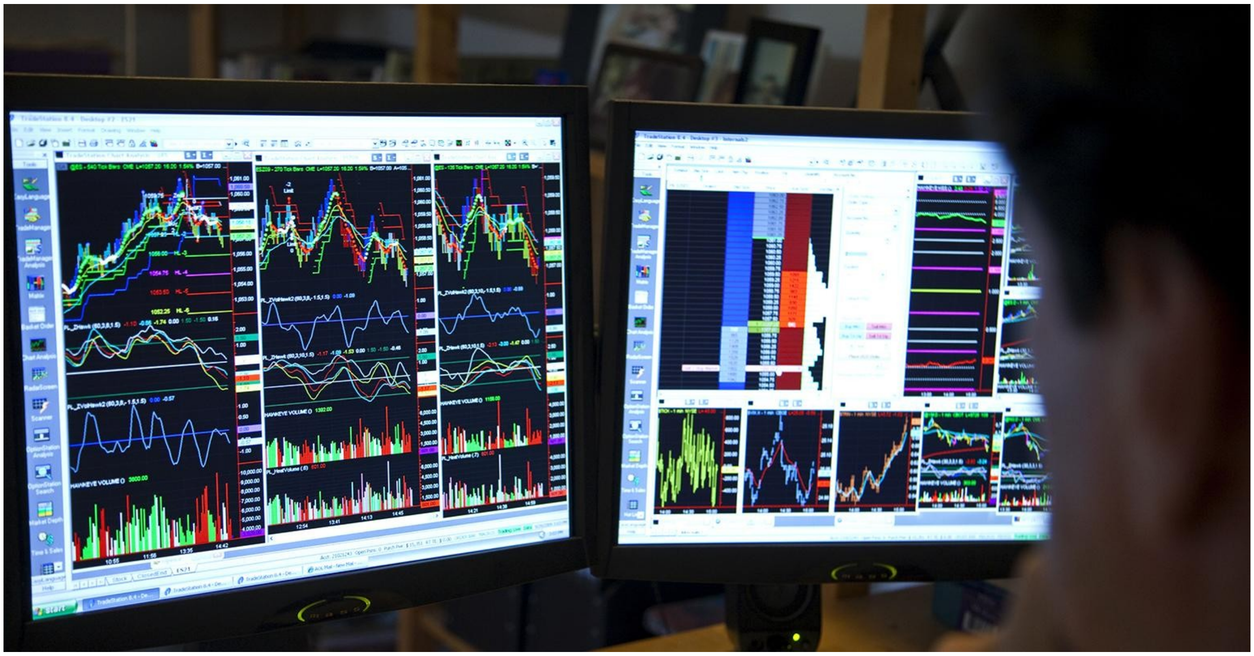

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INVESTMENT>ALTERNATIVE INVESTMENTS

Alts and Advisors: A Mixed Bag

Not every advisor sees a role for alternative investments like private placements or nontraded REITs. For those who do, making the allocations in reaction to declines in traditional portfolios is a mistake.

Rob Burgess | Dec 23, 2022

Almost 9 out of 10 investment advisors and managers plan to increase their clients' portfolio allocations to "alternative investments" over the next two years, according to a survey sponsored by CAIS, a technology platform that connects independent advisors with investment managers across a range of

nonpublicly traded funds, and Mercer Advisors, the $38 billion AUM investment advisory firm based in New York City.

Why the growing interest? A shrinking pool of investable securities in the equity markets and a decade of low yields on debt have prompted advisors to look elsewhere for income and the noncorrelated assets needed to build out client portfolios, according to the firms.

“There were existing trends that I think have been going on for five or 10 years,” said Gregg Sommer, a partner at Mercer who heads up the firm’s financial intermediaries business. “The recent economic conditions have only accelerated that.”

“If you’re not investing in private equity, venture or private credit, you’re not participating in the economy. And that’s what we’re bringing to the table,” said Matt Brown, chief executive of CAIS, during a presentation at Schwab’s recent advisor conference. “If you’re a financial advisor and you’re not including alternative investments in your portfolios, you’re at the risk of losing your business over the next three years.”

Yet the interest in alternatives has not always translated into action, as many advisory firms still struggle with access, and pulling the less liquid, often more opaque investments into their portfolio management and performance reporting workflows.

Tech consultants F2 Strategy conducted a similar survey in June, which found that almost half of wealth management firms actively investing in alternatives expect to slow down the allocations in the coming year.

Doug Fritz, co-founder and chief executive of F2 Strategy, said interest among advisors in the alternatives landscape was a mixed bag, and often comes more from how they position themselves competitively than a reaction to market conditions.

“There are wealth firms that use traditional funds and ETFs and have not had a third and fourth assets class to add to client portfolios. They see that as a gap they must overcome,” he said.

“They’re not really thinking about the economy and less-correlated asset classes. They’re thinking about their competitive stance, and how they can win client mandates, clients that may be going to smaller, independent RIAs that already have a book of alternative assets, or large wirehouses that have had them for a while.”

Ryan S. Cole, managing director of Citrine Capital, said the promise of alternative investments as an enhancement to client outcomes is overhyped.

He said his firm sees interest in alternatives increase during every bear market, only to drop off during bull markets.

“These alternatives are marketed as uncorrelated assets that outperform in bear markets, but they almost never outperform markets. They also usually have really high fees,” said Cole.

“Unfortunately, retail investors usually buy them during bear markets because they get nervous. I would recommend that retail investors steer clear. And if they do want alternative assets that are uncorrelated to act as a hedge against their stock portfolio, then it's usually best to buy those during bull markets. But for the most part I don't ever recommend investing in these,” he said.

Curtis J. Crossland of Suttle Crossland Wealth Advisors said he did see a place for alternatives “but not as a tactical option in volatile markets.”

“Alternative investments should be viewed as a supplemental strategy to the traditional portfolio for most investors,” said Crossland. Part of his rationale was alternatives tend to have different risks associated with them compared with stocks and bonds, but also the potential for unique exposures—and returns—that can’t be found on the public exchanges.

“Hedge funds, private equity or private capital, real estate or infrastructure aren't necessarily known for liquidity. There can be specialized ETFs that give you exposure, but they don't represent all the options,” said Crossland.

He said his firm added alternatives for clients that have assets beyond what’s needed for their lifestyle and basic planning needs.

“Recommending an alternative investment to an investor that is simply frustrated with the current market cycle or seeking alternatives in the hopes of short-term outperformance,” is to act on irrational fears or concerns. The client’s “entire situation should be considered and weighed before any recommendations are made.”

Ryan Bouchard, founder and chief investment officer of Rising Tide Wealth Advisory Solutions, said he saw a recent rise in interest for alternative investments from clients and prospects.

“I think for the past 10 years or so, ‘alts’ was kind of a bad word. And I think especially this year when interest rates have risen so much, I think a lot of advisors are taking a second look at the role of alternatives in portfolios,” said Bouchard.

Bouchard said his firm looked to alternative investments to serve as the “ballast” of a portfolio, a role that traditionally had been played by bonds.

“(Bonds were) supposed to hold up whenever equity markets fell. And interest rates got lower and lower over the last decade, it became evident that at some point, bonds were not going to be the savior of the overall portfolio. We encouraged people to diversify some of that bond exposure into alternatives,” said Bouchard.

But it takes time and research to find the appropriate investments for the clients. “Investors and advisors need to understand exactly what they’re getting into, and they need to understand these liquidity gates. The more that investors learn about this stuff, they’re asking their advisors what they should be doing. And I think advisors do need to have an understanding. They need to know what’s available out there. The universe of alternatives is getting bigger and bigger every day.”